

Does running a hot economy benefit disadvantaged workers and reduce inequality?

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** The views expressed here are my own and do not necessarily reflect the views of other staff members, officers, or trustees of the Brookings Institution. I would like to thank Janina Bröker for her research assistance in support of this presentation.*

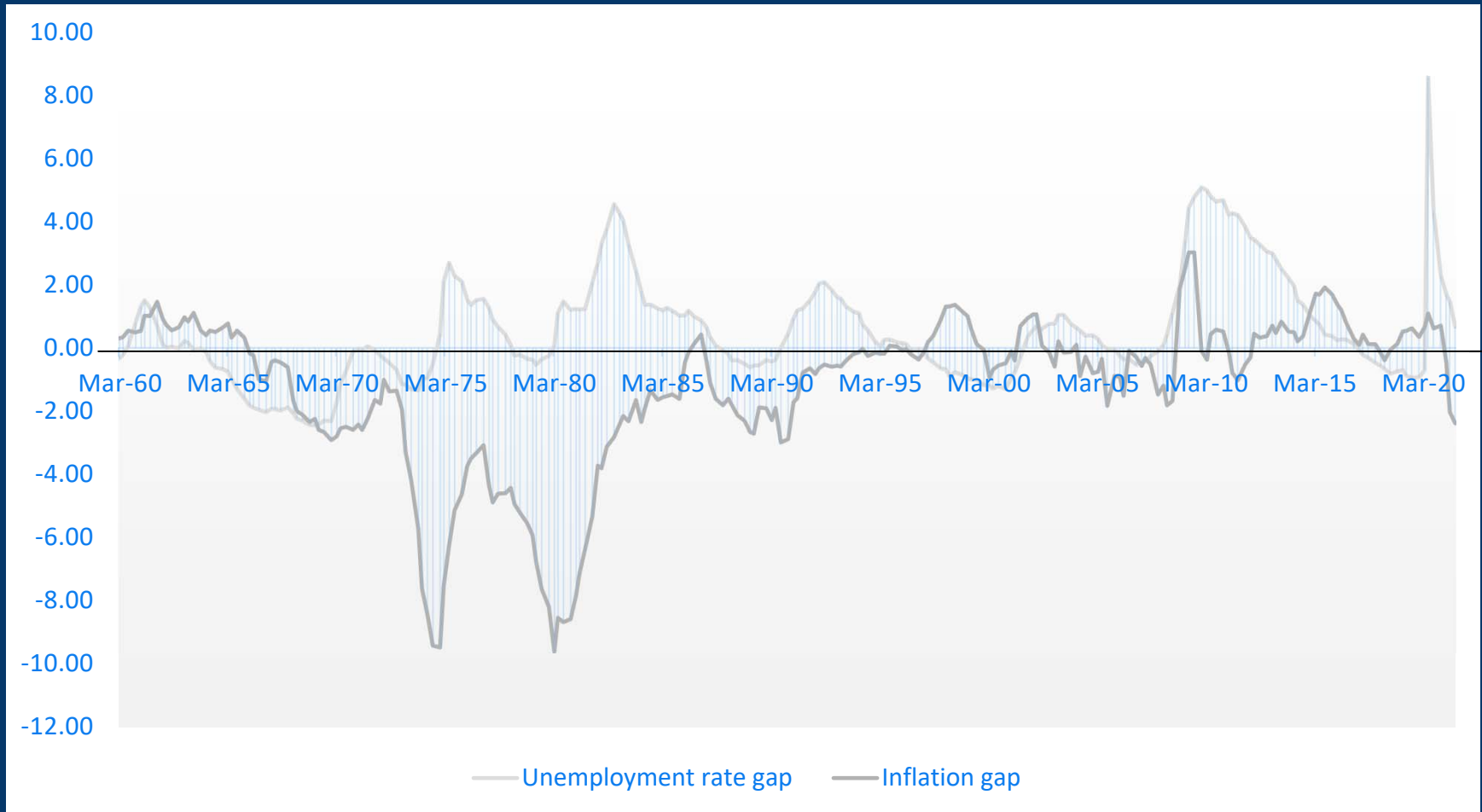
How do we talk about the phenomenon we are interested in?

“3% is a low unemployment rate, but to call something hot, you need to see some heat...”

--Jerome Powell, Testimony before the Committee on Financial Services, U.S. House of Representatives, July 10, 2019



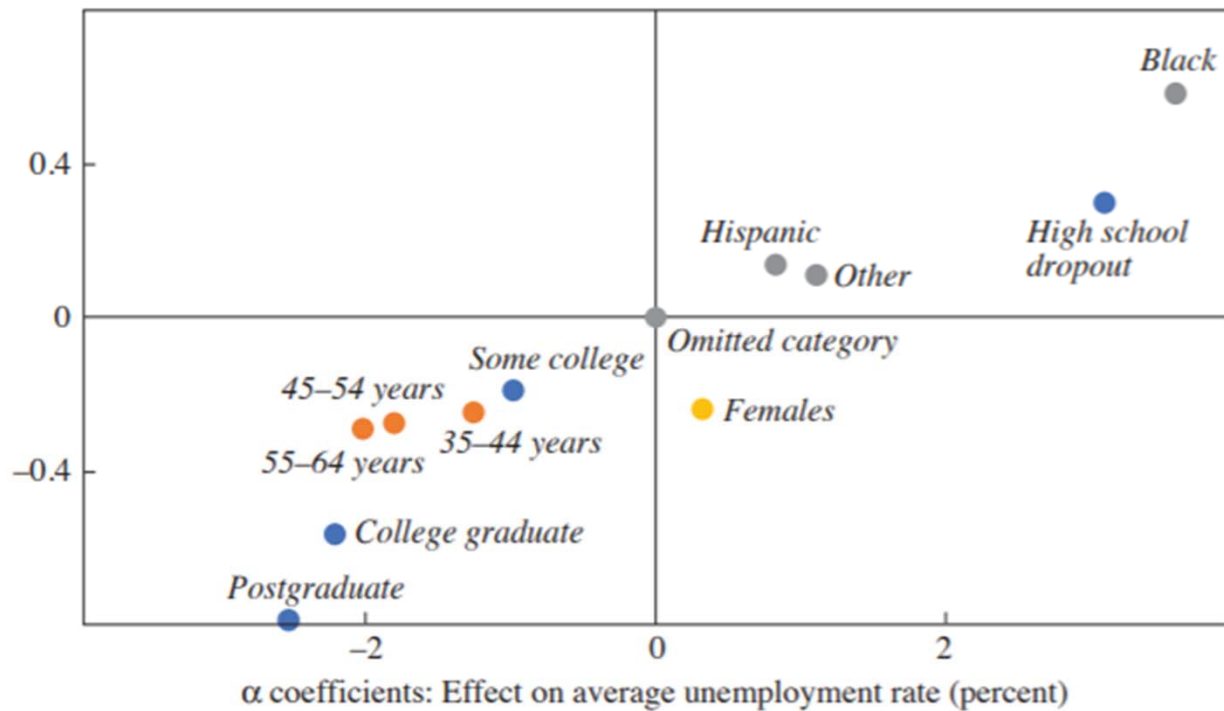
What does it even mean to be a 'Hot' labor market



Workers with higher unemployments have more cyclical unemployment rates

Figure 3. Regression Results Showing How Demographic Characteristics Shape the Average Level and Cyclicity of Unemployment

β coefficients: Effect on cyclicity

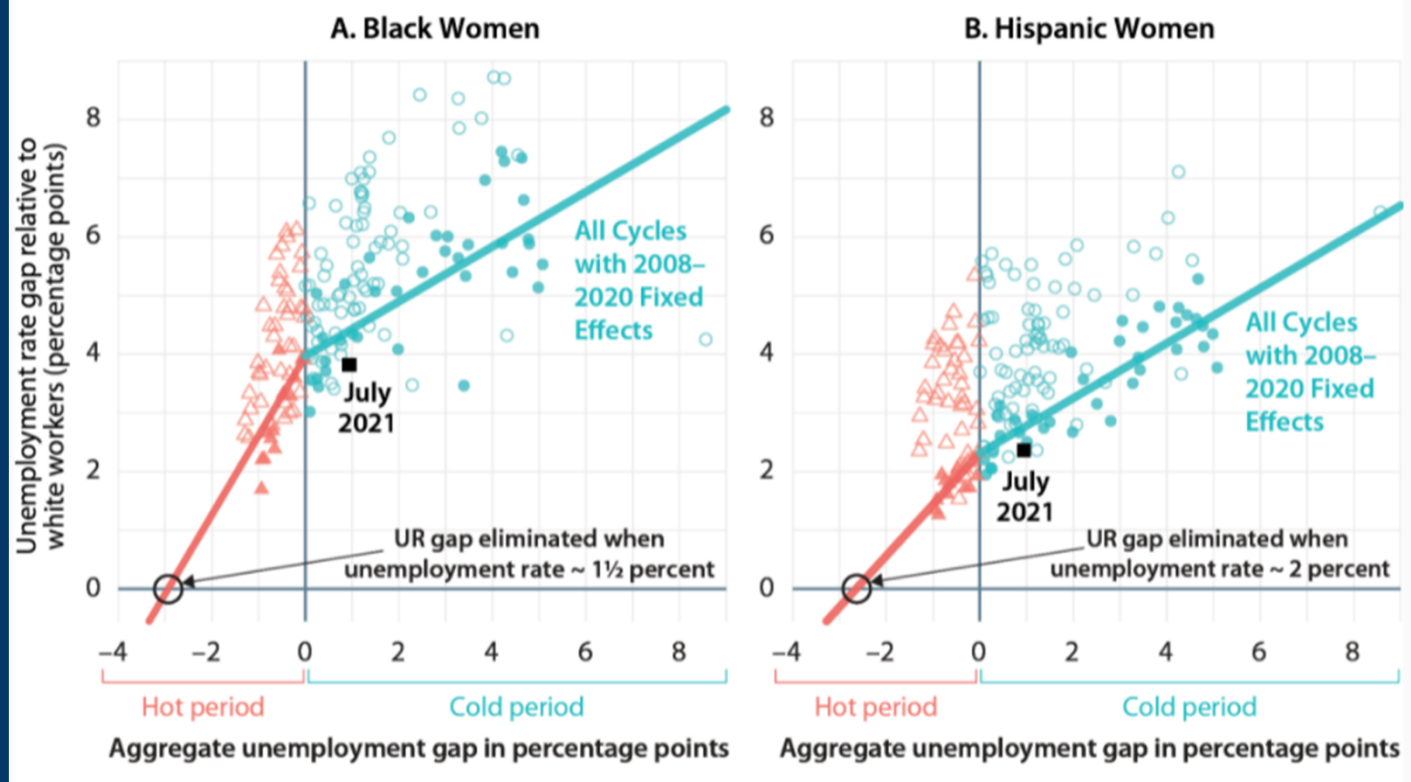


Source: Author's calculations, using the Current Population Survey.

Gaps between Black and Hispanic workers and white workers closer faster when $U < NR$

FIGURE 4.

Unemployment Rate Gap Sensitivity to Aggregate Unemployment Rate Gap, Women

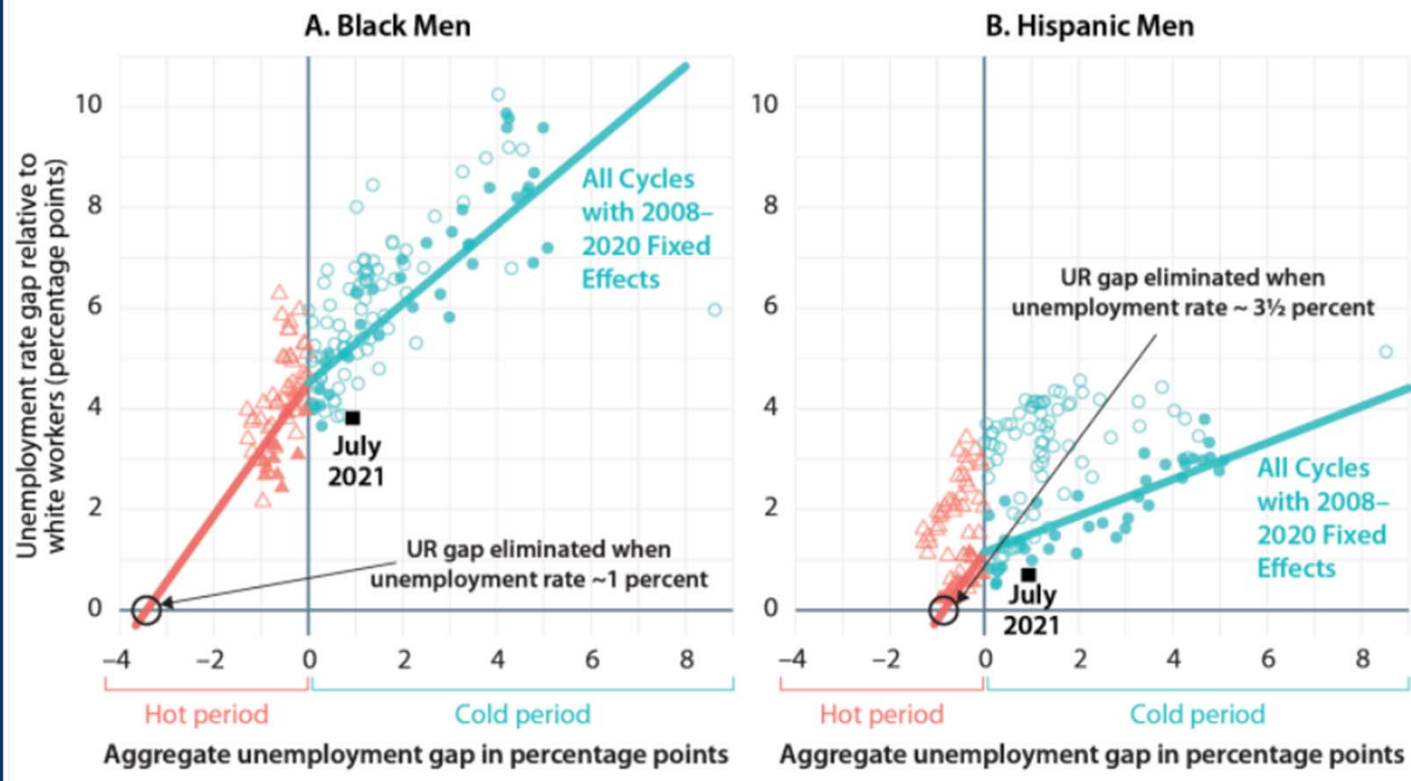


Source: Aaronson, Barnes and Edelberg 2021.

Men too.

FIGURE 3.

Unemployment Rate Gap Sensitivity to Aggregate Unemployment Rate Gap, Men



Source: Aaronson, Barnes and Edelberg 2021.

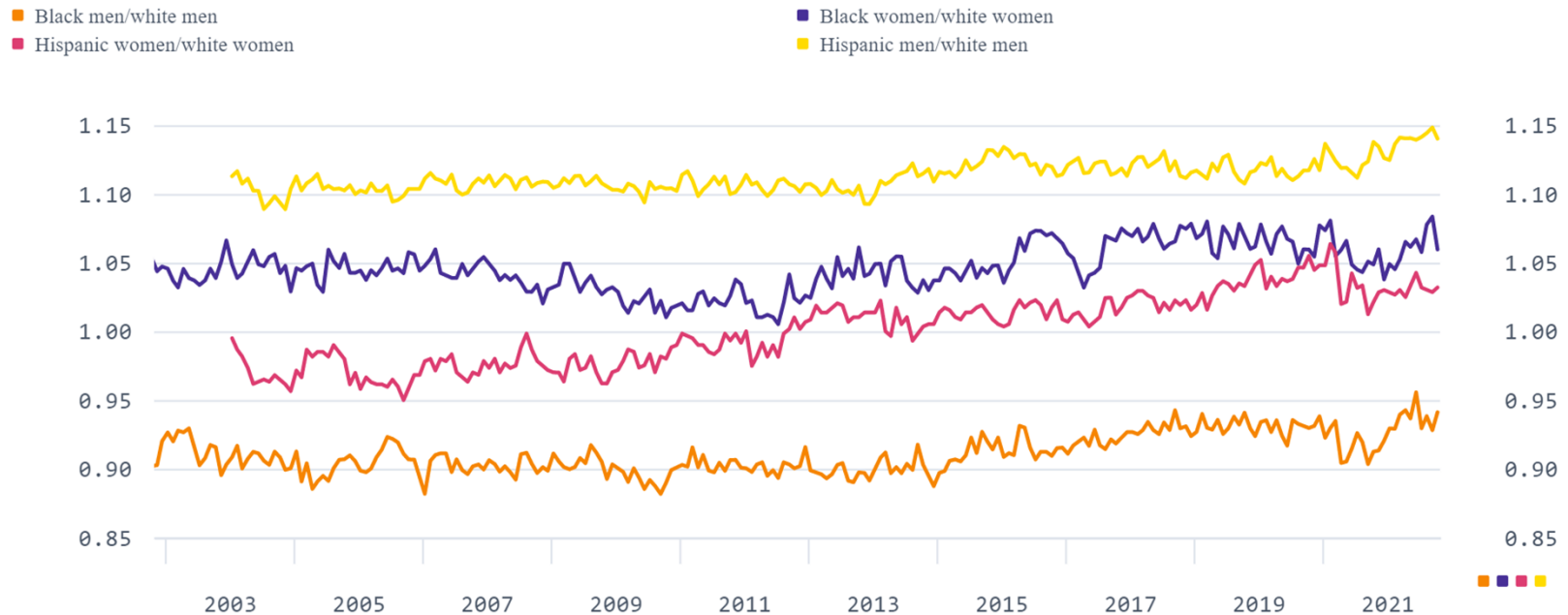
Summary of ADWW results

Low unemployments benefit some groups									
		Black men	Black women	Hispanic men	Hispanic women	High school or less men	Some college men	High school or less women	Some college women
Unemployment rate		**	**	*				*	
Nonparticipation		*	*					*	*

- Men with less than a college degree do not benefit from unemployment rates below NR
- For some groups low unemployment rates reduce LFPR gaps, but the evidence is weaker and there is less cyclical than for unemployment rate gaps

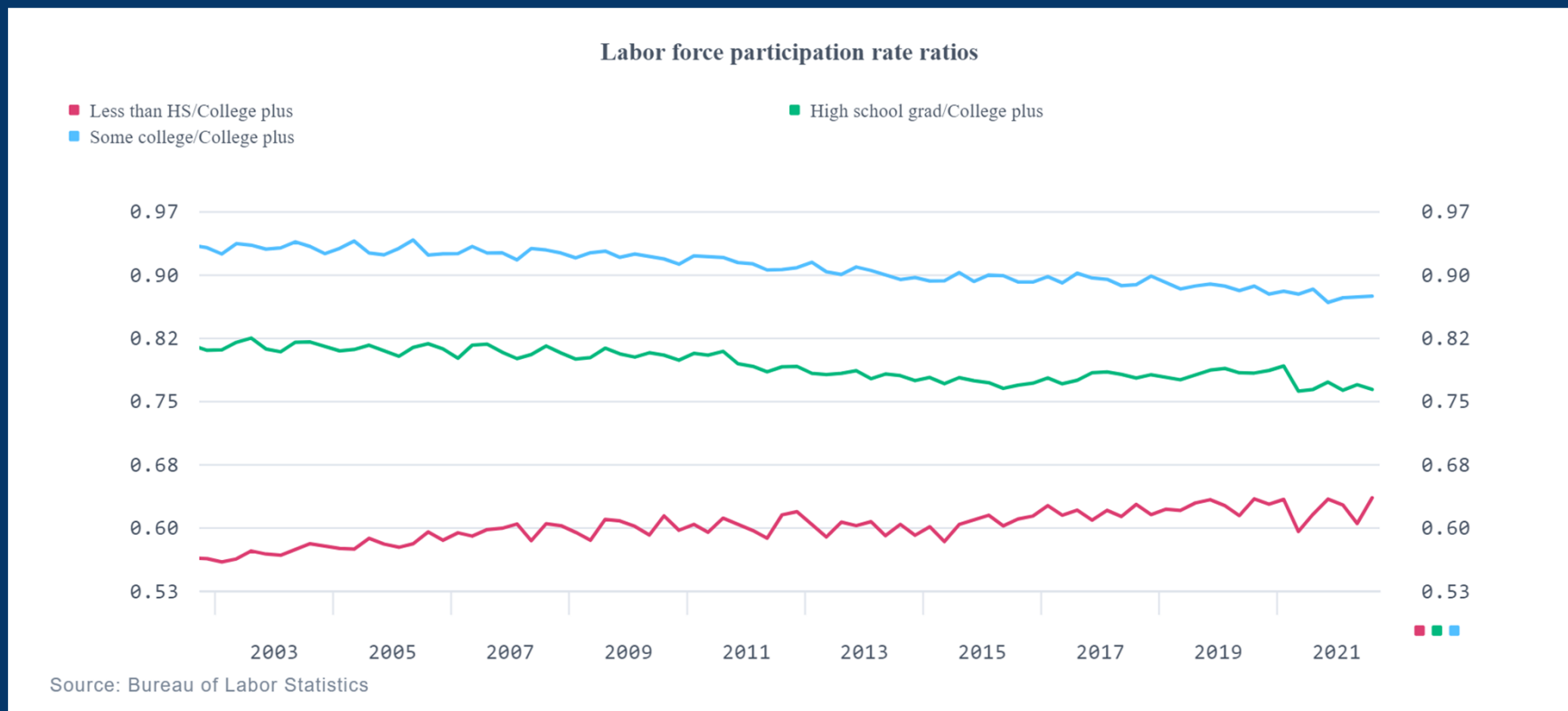
Racial/ethnic groups with higher unemployment rates do not all have lower LFPR

Labor force participation rate ratios



Source: Bureau of Labor Statistics

In contrast, the relationship does hold by education

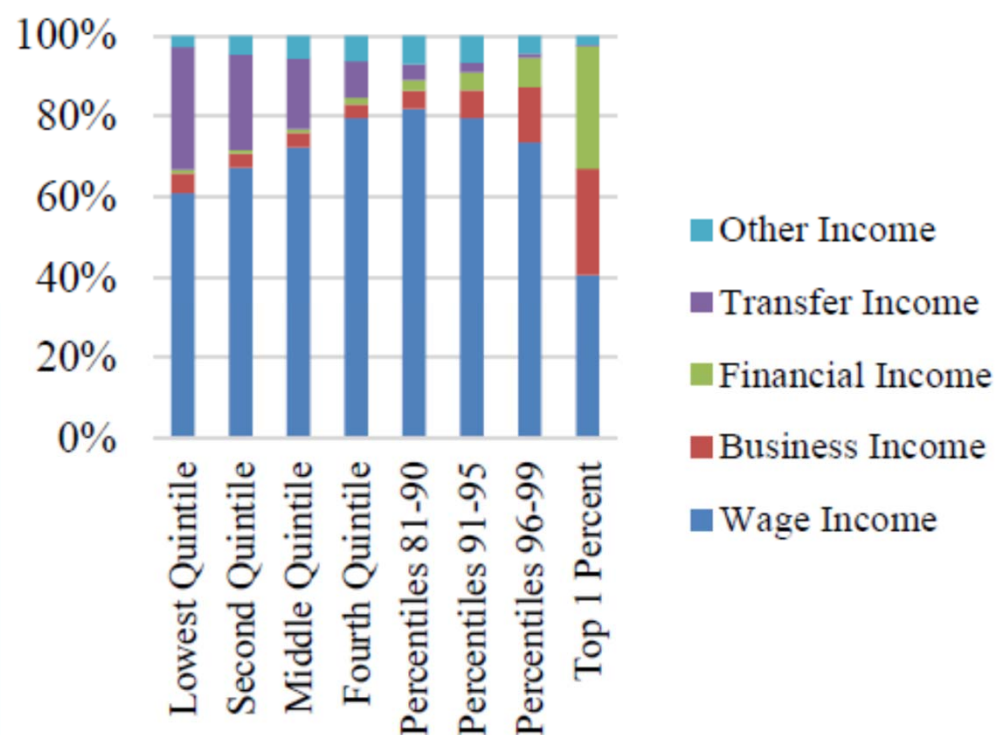


Income Inequality: Not much evidence on ‘hot’ labor markets

- Poverty strongly countercyclical (Romer & Romer, 1998, etc., etc.)
- Some evidence (ADWW) of impact of low unemployment rates on (CPS) annual earnings for some groups, but not wages (consistent with Doniger, 2021).
- No clear evidence of expansions on overall income inequality
 - Evidence that income for high earners is more procyclical (Parker and Vissig-Jorgensen, 2010).

Sources of income are subject to different shocks and behave differently

Working-Age Households:
Composition of Money Income



- Transfer income cushions downturns for low-income Households, but less in strong economies
- Capital gains and business income are also procyclical
- Interest income lower if interest rates driven lower by more accommodative monetary policy, *cp.* (Feiveson, et al, 2020)
- In any given cycle how will these factors play out?

Consideration 1: There is considerable heterogeneity across cycles

- ADWW finds the low unemployment rates of late 1990s more beneficial than in 1980s or 2000s.
 - Sectoral differences
- Years 2016-2019 saw strong income growth for households outside of the top 1% and declines for those in the top 1%, but during 2004-2007, income growth drive by top 1% (Bhutta et al, 2020).
- Pandemic recession saw strong asset prices

Consideration 2: Positive hysteresis would improve the unemployment inflation trade-off

- Very little evidence of hysteresis in the unemployment rate on aggregate
 - ADWW may find some evidence for low-ed workers, white women
- There is some evidence of hysteresis in the LFPR/employment-population ratio.
 - ADWW, Fallick and Krowlikowski, 2018; Hotchkiss and Moore, 2018; Kahn 2010; Kondo, 2015; Oreopolous et al, 2012.
 - Hysteresis appear to persist for several years

Consideration 3: Inflation

- Inflation could be redistributive in that low-income people are more likely to be borrowers, while high-income people are more likely to have net savings.
- The consumption basket of low-income households seems more sensitive to inflation (Cravino, Lan, and Levchenko, 2020).
- Impact on monetary policy: ‘no recessions, please’

Final thoughts

- Disadvantaged workers experience much better employment and earnings outcomes as the unemployment rate falls, and there is evidence that some groups benefit disproportionately the lower it gets, **but this need not be the case to press for a policy that supports full employment.**
- There is some evidence of hysteresis. It could be that it is of sufficient duration that it could be salient for monetary policy decision making.
- The cyclical nature of income and wealth are less clear, and there isn't much evidence on how they are affected by very low unemployment rates
- Monetary policy, including QE, is a powerful but blunt tool.